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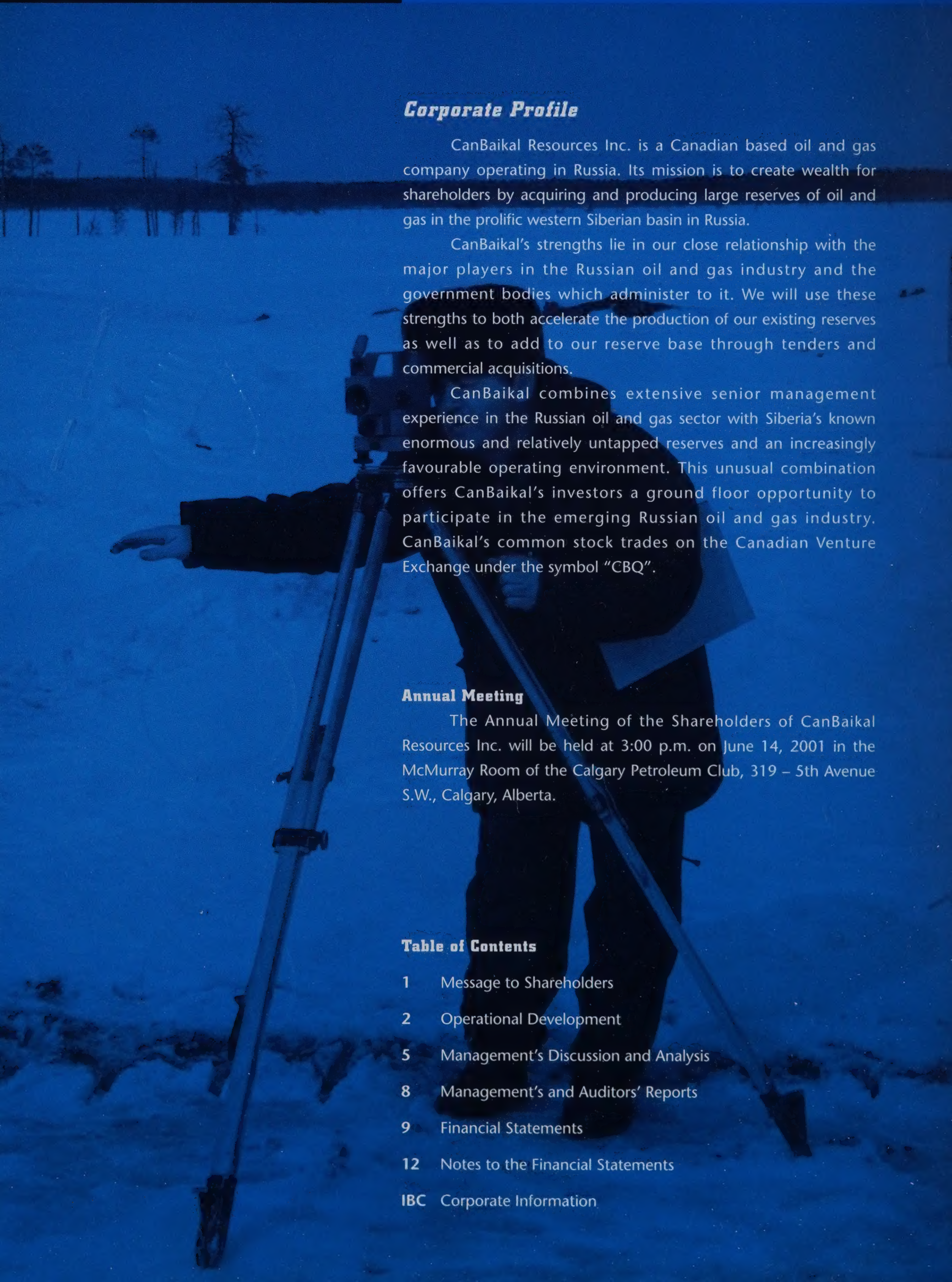
CanBaikal Resources Inc.

Annual Report



Corporate Profile

CanBaikal Resources Inc. is a Canadian based oil and gas company operating in Russia. Its mission is to create wealth for shareholders by acquiring and producing large reserves of oil and gas in the prolific western Siberian basin in Russia.

CanBaikal's strengths lie in our close relationship with the major players in the Russian oil and gas industry and the government bodies which administer to it. We will use these strengths to both accelerate the production of our existing reserves as well as to add to our reserve base through tenders and commercial acquisitions.

CanBaikal combines extensive senior management experience in the Russian oil and gas sector with Siberia's known enormous and relatively untapped reserves and an increasingly favourable operating environment. This unusual combination offers CanBaikal's investors a ground floor opportunity to participate in the emerging Russian oil and gas industry. CanBaikal's common stock trades on the Canadian Venture Exchange under the symbol "CBQ".

Annual Meeting

The Annual Meeting of the Shareholders of CanBaikal Resources Inc. will be held at 3:00 p.m. on June 14, 2001 in the McMurray Room of the Calgary Petroleum Club, 319 – 5th Avenue S.W., Calgary, Alberta.

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Message to Shareholders

Dear Shareholder:

The year 2000 marked the beginning of continuous oil production and sales from the Company's Untegey block in Russia. Other accomplishments include the completion of a 28 km pipeline and metering and pumping facilities on the block. This line connects the Kulun pool in the east and the Untegey pool in the west to the main delivery pipeline 7 kms north of our block and these lines connect to the Russian oil distribution system for internal and export deliveries. Our new facility allowed the company to initiate continuous production from well #10 in the Kulun pool which resulted in total year 2000 sales of 56,122 bbls including the initiation of export sales with a sale of 22,000 bbls in December 2000.

The Company is now cash flow positive with a cash flow from operations of $452,229 or $0.02 per share and earnings, after provision for recovery of income taxes, of $2.9 million or $0.14 per share. Our balance sheet is strong, with corporate assets increasing from $0.6 million to over $7.0 million including cash and accounts receivable of $1.3 million. Shareholder equity increased by 172% to $6.3 million.

We are now moving to exploit a plan of drilling and production. We expect the oil price market to remain relatively stable throughout 2001 and we expect a significant improvement in cash flow from operations again in 2001. The Russian political and regulatory environment has remained stable and we do not expect negative changes in the coming years. Your company intends to drill three wells over the next 12 months and expects our production and reserve base to rise proportionately.

With the increased stability of oil prices came an improvement in capital markets and the Company was successful in raising $2.5 million through equity instruments as well as a $0.5 million of convertible debt, issued in 2000. A flow-through share issue of $0.5 million will be used to acquire an interest in a Canadian exploration property in 2001.

2001 promises to be break through year for CanBaikal. The confluence of high oil prices and low interest rates encourage us to initiate arrangements to raise sufficient capital to carry out a more aggressive development plan in 2001 – 2002.

The Board of Directors and management of CanBaikal Resources Inc. wishes to thank our shareholders for their continuing support and we hope to provide adequate rewards for investors who have kept faith in CanBaikal.

R. J. Bolton

Robert J. Bolton
President and CEO

Robert W. Lamond
Chairman

Operational Development

In late 1999 – 2000, despite the abnormally warm weather conditions in December and January, construction began on our planned winter roads. Well #10 was brought into production in February 2000 and 5,600 bbls of oil were trucked before the spring thaw.

The Company has carried out the design and construction of a 28 km pipeline connecting well #2 (Untegey pool), well #10 (Kulun pool) and the main distribution pipeline. The pipeline was completed in June 2000, and the pumping and metering facilities were tied in during July. The continuous production from well #10 through the pipeline and onwards to the Russian sales system commenced on August 8, 2000. The total production from well #10 during 2000 was 56,122 bbls or an average daily production rate of 440 bbls per day. The maximum daily rate was 606 bbls per day.

The Company also re-entered well #2 to prepare it for future production in early 2000. The pad on which well #2 is situated required additional upgrading in the winter of 2001 before the well could be fraced, tied into the pipeline and placed on production. This work commenced in the winter season of 2001 and the well was placed on production in April 2001. CanBaikal estimates production rates from the two wells will exceed 750 bbls per day for 2001.

CanBaikal's Untegey Block license is included in the list of licenses approved by the Regional Administration to be eligible for a Production Sharing Agreement. The Regional Administration is currently awaiting Russian Federal approval of this list that will ensure a stable fiscal regime for the life of the CanBaikal license. On April 11, 2000 the Company was included in the formal list of Russian petroleum producing companies. This recognition ensures that CanBaikal may produce, access pipelines and transportation systems and sell oil on the internal Russian market or on the export market at its sole discretion and without recourse to Russian intermediaries or joint venture partnerships.

In the fourth quarter of 2000, CanBaikal received all administrative permissions to export oil from Russia. The Russian Oil Ministry has a quota system for the amount each producer may sell on the domestic or export markets. In December, CanBaikal exported 22,000 bbls of crude at a price of $28.65.

CanBaikal's Current Operation Area

Oil Reserves

The Company's oil reserves were evaluated, as at January 1, 2001 by the independent engineering firm of Gilbert Laustsen Jung Associates Ltd. (GLJ) and are summarized as follows:

	Total Proved	Proved plus Probable	Proved plus Probable plus Possible
Marketable Oil Reserves (000's barrels)			
Gross Company Interest (100%)	5,524	20,037	67,690
Present Value of Future net Cash Flow			
After Russian Tax (million $)			
Undiscounted	25.5	128.4	457.1
@ 10%	16.7	67.1	199.4
@ 15%	13.8	50.6	138.0

The above reserves values are based on GLJ's January 1, 2001 forecasted prices, which assumes 35% of the production will be sold on the export market and the balance to the Russian domestic market. GLJ's forecasted Brent Blend crude oil price for 2001 is $25.50 US/bbl. All reserve values are presented in Canadian dollars assuming a US dollar to Canadian dollar conversion rate of 1.5. Although the Company produces natural gas in association with oil, the gas volumes are small and will be consumed locally in the production facilities.

Reserve Definitions

Proven Reserves: Those reserves estimated as recoverable with a high degree of certainty under current technology. In the estimates that use constant price and cost analysis, the estimates are made using the existing economic conditions. In the estimates that use escalated price and cost analysis, the estimates are made using anticipated economic conditions. In both cases the Proven Reserves are extracted from that portion of the reservoir which can be reasonably evaluated as economically productive when analyzed using drilling, geological geophysical and engineering data. Proven Reserves include the reserves obtained by enhanced recovery processes demonstrated to be economic and technically successful in the subject reservoir.

Probable Reserves: Those reserves, estimated by the analysis of drilling, geological, geophysical and engineering data, that do not meet the requirements for Proven Reserves, but where the analysis suggests the likelihood of their existence and future recovery under current technology and existing or anticipated economic conditions. Additional Probable Reserves may be estimated by the application of existing enhanced recovery processes that may be reasonably expected to be instituted in the future. These additional reserves are calculated as over and above those calculated by enhanced recovery in Proven Reserves.

Possible Reserves: Those reserves which cannot be classified as either proved or probable at the present time because of relatively high uncertainty but which could be reasonably be expected to be recovered with additional successful drilling and/or optimum production performance.

Management's Discussion & Analysis

The year 2000 was a busy year for CanBaikal, completing the construction of a 28 km pipeline on August 8, 2000 and thereby securing continuous production from the Company's Untegey lease. CanBaikal accomplished this while maintaining a very low debt level and the Company is now positioned for significant growth in the future.

Production

CanBaikal began trucking oil from well #10 in February 2000 until breakup and continuous daily production commenced August 8, 2000 after the completion of the 28 km pipeline. Since commencing production into the pipeline, well #10, had production as high as 606 bbls/d and has maintained steady production rates of approximately 400 bbls/d.

Revenues

In 2000, the Company's gross revenue from oil sales of 56,122 bbls was $1,465,881 or $26.11/bbl, and net after oil taxes and royalties was $1,222,403, or $21.78/bbl. In 2000, CanBaikal was approved by the Russian authorities to sell oil either domestically or on the export market. In 2000 the export quota per company was regulated by the Russian authorities to a maximum of 30% of production. The Company sold it's first export sale of 21,900 bbls at $28.65/bbl gross in December 2000. The quota system for export oil in 2001 allows the Company to export a minimum of 35% of production. Based on current pricing, the Company received approximately 35% more revenue for export oil sales than for domestic oil sales.

Operating Costs

During the year, operating costs were $174,951 or $3.12/bbl. With increased production volumes from the second well on the License, CanBaikal expects operating costs per barrel to decline in 2001.

General and administrative costs for the year were $556,483, net of $523,448 capitalized. This compares with a cost of $499,279 net of $145,044 capitalized in 1999. The higher overhead costs and the higher level of capitalized costs reflect the significantly increased level of activity during the year, with the construction of the pipeline and preparation for completing and connecting the second well.

Depletion and Depreciation

As a result of the commencement of production, the Company began to deplete its previously capitalized exploration costs. The Company depleted the present and future costs required to develop proved reserves on a unit of production basis. Depletion costs were $4.04 per barrel of oil sold in 2000.

Income Taxes

During the year ended December 31, 2000, CanBaikal recorded a recovery of future income taxes of $2,755,255, increasing its future income tax recoverable to $3,028,062. The recovery reflects the recognition of the income tax benefit which resulted from prior period accounting losses.

The benefits were not recognized in prior financial periods, because there was not reasonable certainty that the Company would generate sufficient taxable income in the future to benefit from the losses.

During 2000, CanBaikal commenced continuous production from its property and oil prices stabilized at significantly higher levels than had been seen in the past. This, combined with a more stable government and tax situation in Russia, resulted in a likelihood that the tax pools would be used in the future and therefore the benefits of the tax losses were recognized.

Capital Expenditures

During 2000, the Company incurred capital expenditures of $2.4 million. The construction of the pipeline and related facilities accounted for $1.4 million of the costs. The remainder of the capital expenditures consists of $0.5 million of capitalized overhead and $0.5 million of the costs related to the completion of the two wells and maintaining the Company's properties in good standing.

Financings and Capital Resources

During 2000, $2.8 million was raised through equity and debt issues to finance the Company's operations. In January 2000, CanBaikal issued 4,166,667 shares at $0.30 per share, to commence the construction of the pipeline. In May 2000, the Company raised a further $560,000 through the issuance of a 10% convertible debenture, convertible at $0.33 per share. During the year, $235,000 of the debentures were converted into 712,121 common shares.

In September, the Company issued a further 4,994,218 common shares pursuant to a rights offering, whereby each shareholder had the right to purchase a full share at $0.20 per share, for every four shares held. The proceeds were used to finance the remainder of the pipeline construction.

Finally, in December 2000, the Company issued 1,635,333 common shares on a flow-through basis, at a price of $0.30 per share. The proceeds were initially used to finance the completion and tie in of the second well on the property. However, as a result of this flow-through issue, the Company has the obligation to incur and renounce $490,600 of Canadian Exploration costs, prior to December 31, 2001.

During 2000, capital expenditures of $2.4 million were financed out of cash flow from operations of $0.5 million, and the balance was financed out of the above equity issues.

At December 31, 2000, CanBaikal had working capital of $866,251 and an outstanding $325,000 convertible debenture which is due April 30, 2002.

License Status

CanBaikal's license terms have recently been modified to allow the Company two additional years to drill three wells and shoot or process additional seismic on the property, extending the evaluation commitment period to February 2004.

CanBaikal is currently planning to drill three wells and shoot the seismic over the 2001 – 2002 exploration season. CanBaikal anticipates cash flow will not be sufficient to finance these plans without additional financing. The Company is therefore currently exploring alternative forms of financing for the coming year, including debt financing, joint ventures and equity alternatives.

Value Per Share

CanBaikal's value per share at January 1, 2001, based upon proven and probable reserves as calculated by Gilbert Laustsen Jung Associates Ltd. are as follows:

(000's, except share data)		
Reserve value, NPV Proved and Probable (12%, after Russian tax)	$	59,700
Working Capital - December 31, 2000		541
Total Asset Value	$	60,241
Basic Shares Outstanding		26,631,419
Fully Diluted Shares Outstanding		29,177,902
Basic Asset Value per share	$	2.26
Fully Diluted Asset Value per share	$	2.10

Business Risk

The Company's operations are currently based entirely in Russia. The political situation, income tax legislation, banking regulations and general operating environment are changing continuously as Russia makes the transition from a command to a market oriented economy. The Company's operations and financial position will continue to be affected by Russian political developments, including the application and interpretation of existing and future legislation and regulations pertaining to production, imports, exports, oil and natural gas and income tax. Management is continuously monitoring the increasing stability of the political and economic environment and is confident that the viability of economic operations will continue to improve.

Outlook

As always in a cyclical resource industry, one must take a long enough view to incorporate both the highs and lows of the cycle. The Russian political situation is stabilizing and both Russian federal and provincial legislation in 2000 is designed to encourage investment in the petroleum sector.

CanBaikal intends to raise the capital required to exploit the significant potential upside of Block 146 and to acquire additional reserves while the current market is favorable. We have continuing plans to enlarge the current reserve base and to form strategic alliances with other companies interested in the development of the Western Siberian basin.

Management's Report

To the Shareholders of CanBaikal Resources Inc.:

Management is responsible for the integrity and objectivity of the information contained in the accompanying financial statements and other financial and operational data contained elsewhere in the report. The accompanying financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada using estimates and careful judgement, particularly in those circumstances where transactions affecting a current period are dependent upon future events. The accompanying financial statements have been prepared using policies and procedures established by management and reflect fairly CanBaikal's financial position, results of operations and cash flow, within the framework of the accounting policies in the notes to the financial statements.

Management has established and maintains a system of internal control designed to provide reasonable assurance that assets in Canada and Russia are safeguarded from loss or unauthorized use and that the financial information is reliable and accurate.

Grant Thornton LLP, the independent auditors appointed by the shareholders, have audited the Company's financial statements in accordance with generally accepted auditing standards and their report follows. Their examination provides an independent view as to management's responsibilities insofar as they relate to the fairness of reported operating results and financial position of CanBaikal.

The Audit Committee of the Board of Directors has reviewed the financial statements with management and the external auditors. The Board of Directors has approved the financial statements on the recommendation of the Audit Committee.

R. J. Bolton

Robert J. Bolton
President and Chief Executive Officer
April 26, 2001

J McGruther

John W. McGruther
Controller and Corporate Secretary

Auditors' Report

To the Shareholders of CanBaikal Resources Inc.:

We have audited the balance sheets of CanBaikal Resources Inc. as at December 31, 2000 and 1999 and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2000 and 1999 and the results of its operations and its cash flows for the years then ended in accordance with generally accepted accounting principles in Canada.

Grant Thornton LLP

Calgary, Alberta
March 21, 2001

Grant Thornton LLP
Chartered Accountants

Balance Sheets

As at December 31,

	2000	1999
Assets		
Current Assets		
Cash and cash equivalents	$ 568,252	$ 177,723
Accounts receivable	707,082	24,864
	1,275,334	202,587
Petroleum and natural gas properties (Note 4)	2,271,595	145,044
Fixed assets (Note 3)	162,971	160,921
	2,434,566	305,965
Other Assets		
Value added tax recoverable	264,305	–
Future income tax recoverable (Note 5)	3,028,062	–
Deferred financing charges	–	94,745
	$ 7,002,267	$ 603,297
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	$ 409,083	$ 58,248
Subscriptions payable	–	200,200
Convertible debenture (Note 8)	325,000	–
	734,083	258,448
Shareholders' Equity		
Capital stock (Note 6)	10,024,673	7,034,982
Deficit	(3,756,489)	(6,690,133)
	6,268,184	344,849
	$ 7,002,267	$ 603,297

Commitments and contingencies (Note 9)

See accompanying notes to the financial statements

On behalf of the Board

R. J. Bolt

Director

Director

Statements of Operations and Deficit

For the years ended December 31,

	2000	1999
Revenue		
Oil sales	$ 1,222,403	$ –
Expenses		
Operating expenses	174,951	–
General and administrative	556,483	499,279
Interest expense	38,740	–
Depreciation and depletion	273,840	50,780
	1,044,014	550,059
Net earnings before income tax	178,389	(550,059)
Future income tax recoverable (Note 5)	2,755,255	–
Net earnings (loss) for the year	2,933,644	(550,059)
Deficit, beginning of year	(6,690,133)	(6,140,074)
Deficit, end of year	$ (3,756,489)	$ (6,690,133)
Earnings (loss) per share – basic	$ 0.14	$ (0.04)
Weighted average number of basic shares	20,886,190	14,135,101
Earnings (loss) per share – diluted	$ 0.14	$ (0.04)
Weighted average number of diluted shares	21,281,335	14,170,229

See accompanying notes to the financial statements

Statement of Cash Flows

For the years ended December 31,

	2000	1999
Cash provided by (used for):		
Operating Activities		
Earnings (loss) for the year	$ 2,933,644	$ (550,059)
Depreciation and depletion	273,840	50,780
Future income tax recoverable	(2,755,255)	–
Cash flow from (used in) operations	452,229	(499,279)
Change in non–cash operating working capital items (Note 11)	(601,032)	46,357
	(148,803)	(452,922)
Financing Activities		
Private placement of common shares, net	1,058,450	–
Rights offering, net	918,654	–
Convertible debenture, net	552,934	212,896
Flow-through shares issue, net	488,500	–
Subscriptions payable	(200,200)	200,200
Warrants exercised	14,098	–
Options exercised	9,250	–
Deferred financing charges	–	(94,745)
Change in non-cash working capital items (Note 11)	100,088	7,999
	2,941,774	326,350
Investing Activities		
Additions to petroleum and natural gas properties	(2,353,670)	(145,044)
Fixed assets	(48,772)	(14,330)
	(2,402,442)	(159,374)
Net change in cash for the year	390,529	(285,946)
Cash and cash equivalents, beginning of year	177,723	463,669
Cash and cash equivalents, end of year	$ 568,252	$ 177,723
Operating cash flow per share – basic	$ 0.02	$ (0.04)
Operating cash flow per share – diluted	$ 0.02	$ (0.04)

See accompanying notes to the financial statements

Notes to the Financial Statements

December 31, 2000

1. Nature of operations and business risks

The Company was incorporated August 14, 1996 and is engaged primarily in the exploration for and development of petroleum and natural gas in Russia. Since inception, the efforts of the Company have been devoted to the acquisition of exploration and production licenses and the development thereof.

The Company's petroleum and natural gas operations are currently based entirely in Russia. The political situation, income tax legislation, banking regulations and the general operating environment are changing continuously as Russia makes the transition from a command to a market orientated economy. The Company's operations and financial position will continue to be affected by Russian political developments including the application and interpretation of existing and future legislation and regulations pertaining to petroleum and natural gas exploration and production, imports, exports and income tax. It is possible that these developments may have a significant impact on the Company's ability to continue operations. The likelihood of such developments is not determinable. Management is continuously monitoring potential developments and changes as they occur.

2. Summary of significant accounting policies

Use of estimates

The preparation of the financial statements in accordance with generally accepted accounting principles in Canada requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from and affect the results reported in these financial statements.

Depreciation

Depreciation of fixed assets is computed using the declining balance method at the rates indicated in note 3. In the year of acquisition only one-half of the normal depreciation is recorded.

Petroleum and natural gas properties and depletion

The Company follows the full cost method of accounting for its petroleum and natural gas operations. Under this method all costs related to the exploration for and development of petroleum and natural gas reserves are capitalized. Costs include lease acquisition costs, geological and geophysical expenses, overhead directly related to acquisition, exploration and development activities and costs of drilling both productive and non-productive wells. Proceeds from the sale of properties are applied against capitalized costs, without any gain or loss being realized, unless such sale would significantly alter the rate of depletion and depreciation.

Depletion of exploration and development costs and depreciation of production equipment are provided using the unit-of-production method based upon estimated proved petroleum and natural gas reserves. The costs of significant undeveloped properties are excluded from costs subject to depletion.

In applying the full cost method, the Company calculates a ceiling test whereby the carrying value of petroleum and natural gas properties and production equipment, net of recorded future income taxes and the accumulated provision for site restoration and abandonment costs, is compared annually to an estimate of future net cash flows from the production of proved reserves. Net cash flow is estimated using year-end prices, less estimated future general and administrative expenses, financing costs and income taxes. Should this comparison indicate an excess carrying value, the excess is charged against earnings as additional depletion and depreciation.

Financial instruments

The Company has estimated the fair value of its financial instruments, which include cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and subscriptions payable. The Company has used valuation methodologies and market information available as at year-end and has determined that the carrying amounts of such financial instruments approximate fair value in all cases.

Future site restoration and abandonment costs

Estimated future costs relating to site restorations and abandonments are provided for over the life of proved reserves on a unit of production basis. Costs are estimated, net of expected recoveries, based upon Russian legislation, technologies and industry standards. The annual provision is recorded as additional depletion.

Foreign currency translation

Accounts denominated in foreign currency are translated into Canadian dollars using the year-end rate of exchange for monetary assets and liabilities and the rate of exchange in place on the transaction date for non-monetary assets and liabilities and revenues and expenses. Foreign currency gains and losses are charged to operations.

Per share amounts

Basic earnings per common share and cash flow from operations per common share are computed by dividing earnings and cash flow from operations by the weighted average number of common shares outstanding for the year. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments, in accordance with new standards approved by the Canadian Institute of Chartered Accountants, see note 7.

Income taxes
Income taxes are recorded using the liability method of tax allocation. Future income taxes are calculated based on temporary timing differences arising from the difference between the tax basis of an asset or liability and its carrying value using tax rates anticipated to apply in the periods when the timing differences are expected to reverse, see note 5.

Flow-through shares
Resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. Future income tax liability is increased and capital stock is reduced by the estimated tax benefits transferred to shareholders.

Cash and cash equivalents
Cash and cash equivalents consist of cash on hand, balances with banks and investments in term deposits.

Deferred financing charges
The deferred charges incurred during the year relate to costs associated with future financing efforts. If a financing offering was successful these costs were allocated to the cost of the offering. If a financing offer was not successful these costs were expensed.

3. Fixed assets

	Rate	Cost	2000 Accumulated Depreciation	2000 Net Book Value	1999 Net Book Value
Computer hardware	30%	$ 75,896	$ 50,490	$ 25,406	$ 34,608
Office equipment and leaseholds	20%	131,728	59,925	71,803	87,875
Vehicles	30%	115,034	49,272	65,762	38,438
		$ 322,658	$ 159,687	$ 162,971	$ 160,921

4. Petroleum and natural gas properties

	2000	1999
Capitalized costs	$ 2,498,714	$ 145,044
Accumulated depreciation and depletion	227,119	–
	$ 2,271,595	$ 145,044

During the year, $523,488 ($145,044 in 1999) of overhead expenses directly related to exploration and development activities were capitalized.

Future capital expenditures of $20,850,000 (1999 – nil), as estimated by independent engineers, relating to the development of proved non-producing reserves have been included in costs subject to depletion.

Total anticipated costs for site restoration and abandonment for the Russian properties as at December 31, 2000 are approximately $300,000.

5. Income taxes

Effective January 1, 2000, the Company adopted the recommendations of the Canadian Institute of Chartered Accountants with respect to accounting for future income taxes. Under the new recommendations the liability method of tax allocation is used, which is based upon the difference between financial and tax bases of assets and liabilities. Previously, the deferred method was used which was based upon differences between the timing of reporting income and expenses for financial purposes. The Company has adopted this change in accounting policy retroactively, without restating the financial statements of prior periods. As a result, the Company recorded a future income tax asset of $366,386 and an increase to capital stock of $366,386 as at January 1, 2000.

a) The provision for tax expense differs from the expected result obtained by applying the combined Canadian federal and provincial income tax rate of approximately 44.6% to earnings before income taxes. The difference results from the following:

	2000	1999
Net income before taxes	$ 178,389	$ (550,059)
Expected tax expense at combined federal and provincial rate of 44.6%	79,561	(245,326)
Increase (decrease) resulting from:		
Deductible share issue costs	(193,396)	–
Deductible tax costs with zero accounting cost	(1,563,804)	–
Non-capital losses recognized	(1,196,515)	–
Unutilized permanent non-capital loss	193,794	–
Other adjustments	(74,895)	–
Unrecognized tax benefits from loss carry forwards	–	245,326
Future income tax recovery	$ 2,755,255	$ –

b) Future income taxes consist of the following temporary differences:

Petroleum and natural gas properties	$ (1,833,290)
Non-capital loss carry-forward	(1,196,515)
Share issue costs deductible	(193,396)
Unutilized permanent non-capital loss	195,139
	$(3,028,062)

c) The Company has available the following amounts which may be deducted, at the annual rates indicated, in determining taxable income for Canadian income tax purposes of future years:

		2000	1999
Undepreciated capital costs	30% to 100%	$ 1,817,000	$ 326,000
Foreign exploration and development expense	10%	$ 4,715,000	$ 4,271,000
Cumulative eligible capital	7%	$ 13,000	$ 14,300
Financing and share issue costs	20%	$ 434,000	$ 482,560

The Company is required to file tax returns in each of the jurisdictions in which it operates. The prime operating jurisdictions are Canada and Russia.

6. Capital stock

Authorized:

Unlimited common shares, without par value
Unlimited preferred shares, issuable in series

Issued and outstanding common shares:

	2000		1999	
	Number	Amount	Number	Amount
Balance, beginning of year	15,047,731	$ 7,034,982	14,047,401	$ 6,822,086
Tax effect of share issue costs (Note 5)		366,386		
Private placement, net	4,166,667	1,143,826	–	–
Warrants exercised	50,349	14,097	–	–
Convertible debentures exercised, net	712,121	231,085	1,000,330	212,896
Rights Offering, net	4,994,218	954,418	–	–
Options exercised	25,000	9,250	–	–
Flow-through, net	1,635,333	270,629	–	–
Balance, end of year	26,631,419	$10,024,673	15,047,731	$ 7,034,982

2000

On January 28, 2000 the Company issued 4,166,667 common shares at a price of $0.30 per share for net proceeds of $1,143,826 after deducting fees and issue costs (net of tax effect) of $106,174.

On August 4, 2000 the Company issued 712,121 common shares at a price of $0.33 per share, pursuant to a prior convertible debenture arrangement, for net proceeds of $231,085 after deducting fees and issue costs (net of tax effect) of $3,915.

On September 1, 2000 the Company issued 4,994,218 common shares at a price of $0.20 per share, pursuant to a rights offering, for net proceeds of $954,418 after deducting fees and issue costs (net of tax effect) of $44,425.

On December 29, 2000 the Company issued 1,635,333 common shares at a price of $0.30 per share, pursuant to flow-through arrangement, for net proceeds of $270,629 after deducting fees and issue costs (net of tax effect) $2,000, and the estimated tax benefits renounced to the shareholders of $217,971.

1999

On November 30, 1999 the Company issued 1,000,330 common shares and 500,165 purchase warrants upon conversion of outstanding convertible debentures. At December 31, 2000, 399,466 of these were outstanding and are convertible to 199,733 common shares at $0.28 per common share until November 30, 2001.

Stock Options

On June 24, 1997 the Company adopted a stock option plan available to officers, directors and employees of the Company and to key consultants and contractors. On December 31, 2000, 2,663,142 common shares were reserved for issuance under the plan. The options are exercisable up to five years from the date of granting.

The following is the distribution of vested stock options:

	2000		1999	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Stock Options outstanding, beginning of year	1,065,000	$ 0.86	1,065,000	$ 0.86
Granted	885,000	$ 0.37	–	$ –
Exercised	(25,000)	$ 0.37	–	$ –
Cancelled	(245,000)	$ 0.52	–	$ –
Stock options outstanding, end of year	1,680,000	$ 0.63	1,065,000	$ 0.86
Exercisable at year end	1,190,000	$ 0.74	1,065,000	$ 0.86

	Options outstanding			Options exercisable	
Range of exercise prices	Options Exercisable	Weighted Average Remaining Term (years)	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
Under $0.50	1,010,000	3.9	$ 0.31	520,000	$ 0.26
$0.51 to $0.99	–	–	$ –	–	$ –
Over $1.00	670,000	1.4	$ 1.11	670,000	$ 1.11
	1,680,000	3.0	$ 0.63	1,190,000	$ 0.74

7. Per share amounts

The Canadian Institute of Chartered Accountants has approved a new standard for the computations, presentation and disclosure of earnings per share. In the forth quarter of 2000 the Company retroactively adopted the new standard. Under the new standard, the treasury stock method is used instead of the imputed earnings method to determine the dilutive effect of stock options and other dilutive instruments. Under the treasury method only "in the money" dilutive instruments impact the dilutive calculations.

In computing diluted earnings and cash flow from operations per share, 395,145 shares were added to the weighted average number of common shares outstanding during the year ended December 31, 2000 (1999 – 35,128 shares) for the dilutive effect of stock options and warrants. No adjustments were required to reported earnings or cash flow from operations in computing diluted per share amounts.

Prior Period diluted earnings per share and cash flow from operations per share have been restated for this change. If the imputed earnings method had been used to calculate these amounts, the reported amounts would have been:

	2000	1999
Diluted earnings (loss) per common share	$ 0.13	$ –
Diluted cash flow from operations per common share	$ 0.01	$ –

8. Convertible debenture

On May 1, 2000, convertible debentures amounting to $560,000 were issued. The convertible debenture bears interest at 10% per annum until converted. The debenture is convertible by the holder into common shares at $0.33 prior to April 30, 2001 and $0.40 prior to April 30, 2002. The Company could require the holders to convert the debenture into common shares after any period of 10 days, following April 30, 2001, in which the closing market price of the Company's common shares are equal to or greater than $0.60 per share. During 2000, 712,121 common shares were issued pursuant to the debenture.

9. Commitments and contingencies

a) Within the first five years of the term of the exploration and production license, the Company must achieve certain targets for seismic exploration and evaluation and has planned to drill at least two wells by the end of 2002. Under the license, the taxes and payments required to be paid by the Company include: 1% of estimated exploration evaluation costs; 3% of the estimated exploration costs for delineation wells; 7% of the value of production; and other taxes stipulated by the authorities.

b) As at December 31, 2000, $490,600 of exploration costs have been renounced to purchasers of flow-through common shares. The Company is required to expend this amount by December 31, 2001 on qualified expenditures in Canada. As at December 31, 2000, the Company has not incurred any of these qualifying expenditures.

c) On January 30, 1998 the Company entered into a rental agreement for office premises. The office lease expires on February 28, 2003. The Company has a sublease agreement to March 31, 2002. The future estimated operating and rental costs are as follows:

	Gross rent and operating costs	Net rent and operating costs after sublease
2001	$ 247,769	$ 112,652
2002	$ 247,769	$ 213,990
2003	$ 30,971	$ 30,971

10. Segmented disclosures

The Company's petroleum and natural gas exploration and development activities are conducted in Canada and Russia. Management of the Company considers the operations of the Company as one operating segment. The following information relates to the Company's geographic areas of operation:

	2000		1999	
	Revenue	Assets*	Revenue	Assets*
Canada	$ –	$ 73,536	$ –	$ 95,892
Russia	1,222,403	2,361,030	–	210,073
	$ 1,222,403	$ 2,434,566	$ –	$ 305,965

* Includes fixed assets and petroleum and natural gas properties.

11. Statement of cash flow

The net changes in non-cash working capital balances consist of the following:

	2000	1999
Cash (used for) provided by:		
Accounts receivable	$ (682,218)	$ (3,202)
Accounts payable and accrued liabilities	350,834	57,558
Value added tax recoverable	(264,305)	–
Deferred financing charges	94,745	–
	$ (500,944)	$ 54,356

The change in non-cash working capital relates to the following activities:

	2000	1999
Operating	$ (601,032)	$ 46,357
Investing	–	–
Financing	100,088	7,999
	$ (500,944)	$ 54,356

Supplementary information regarding cash payments or receipts :		
Interest paid during the year	$ 38,740	$ –

12. Related party transactions

The following related party transactions occurred at fair market value:

a) During the year, directors and officers of the Company purchased $325,000 of the $560,000 convertible debenture and $450,000 of the $490,600 flow-through placement.

b) During the year, $12,747 in interest was paid to related parties with respect to the convertible debenture.

c) During the year, Humboldt Capital Corporation, a company controlled by a director of the Company, loaned the Company $500,000. The loan was repaid with interest of $14,959 during the year.

13. Financial risk

The Company is exposed to credit risk to the extent of non-performance by third parties in the payment of receivable amounts.

14. Comparative figures

Certain of the 1999 comparative figures have been reclassified in order to conform to the presentation adopted in the current year.

Corporate Information

Directors and Officers

Robert W. Lamond
Director, Chairman of the Board

Robert J. Bolton
Director, President and CEO

Charles A. Teare
Director, Chief Financial Officer

Daryl E. Birnie
Director

Kevin Flaherty
Director

Robert James
Director

Alexander A. Borissov
Vice-President, Business Development

John W. McGruther
Controller and Corporate Secretary

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Nefteyugansk, Russia

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HSBC Bank Canada
Calgary, Alberta

Corporate Engineers

Gilbert Laustsen Jung Associates Ltd.
Calgary, Alberta

Legal Counsel

Fraser Milner Casgrain
Calgary, Alberta

Registrar & Transfer Agent

Computershare Investor Services Canada
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